Thinking About International Low-Cost Carriers

FAA Aviation Forecast Conference
Washington, DC
March 16, 2007

Joshua Marks
Senior Vice President, Planning, Development & People
MAXjet Airways Inc.

Background

Long-haul flying is inherently different from short-haul.

- Crew requirements
- Security requirements
- Airport facilities & turn times
- Route authorities
- ETOPS and training differences
- Distribution challenges
- Route density

To be successful an entrant must seek real advantage in these factors…

… and find markets where <u>lower</u> fares than the competition can be profitable.

Enabling Factors

High Fares in Key Markets

Opens pricing umbrella for new entrants
Strengthens value proposition

Availability of Quality Long-Range Aircraft

Fuel efficiency on long-haul routes
Affordable acquisition price

Liberalized Route Authorities

New entrants can build networks based on market demand, competition

Customer Acceptance of Secondary Airports

Lower costs, gate and slot availability at key airports in major cities

Regional LCCs Building Hubs and Looking for Partners

Strengthens a point-to-point int'l network with connecting traffic

Disabling Factors

Restructured Legacies

Legacy airlines are leaner than ever and continue to innovate with product

Network Alliances & Affinity Programs

Connecting flow builds frequencies while affinity programs lock-up key accounts

ETOPS & Overflight Issues

New entrants must qualify for ETOPS and face other operational challenges

High Capital Requirements

High initial cost to establish brand and open new markets requires capital

Labor Pools

Uneven supply of qualified pilots and cabin crew around the world

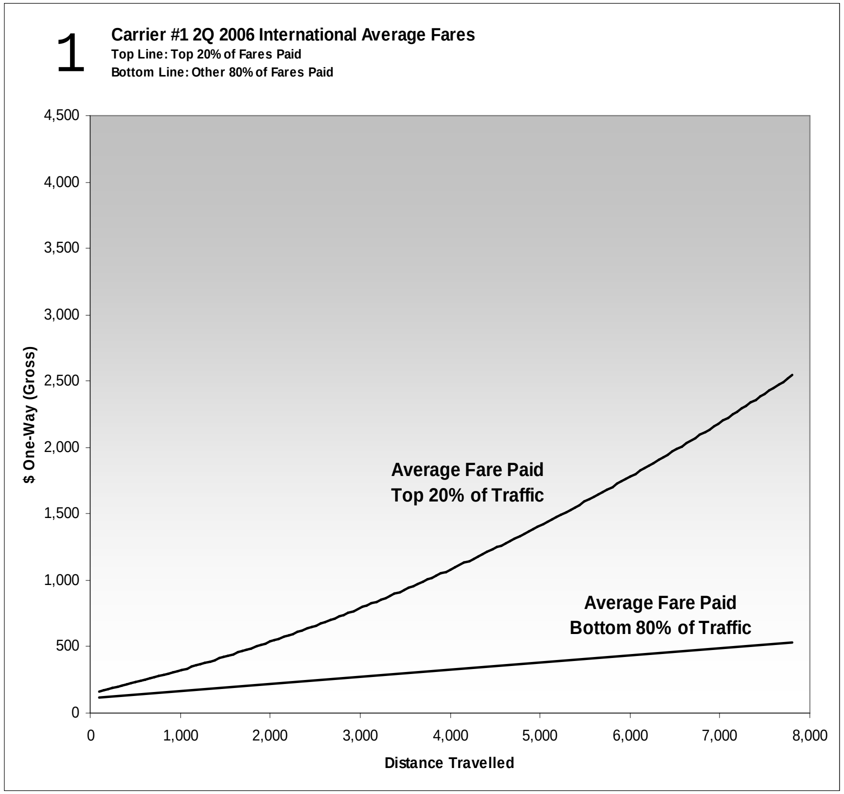
The Core Problem

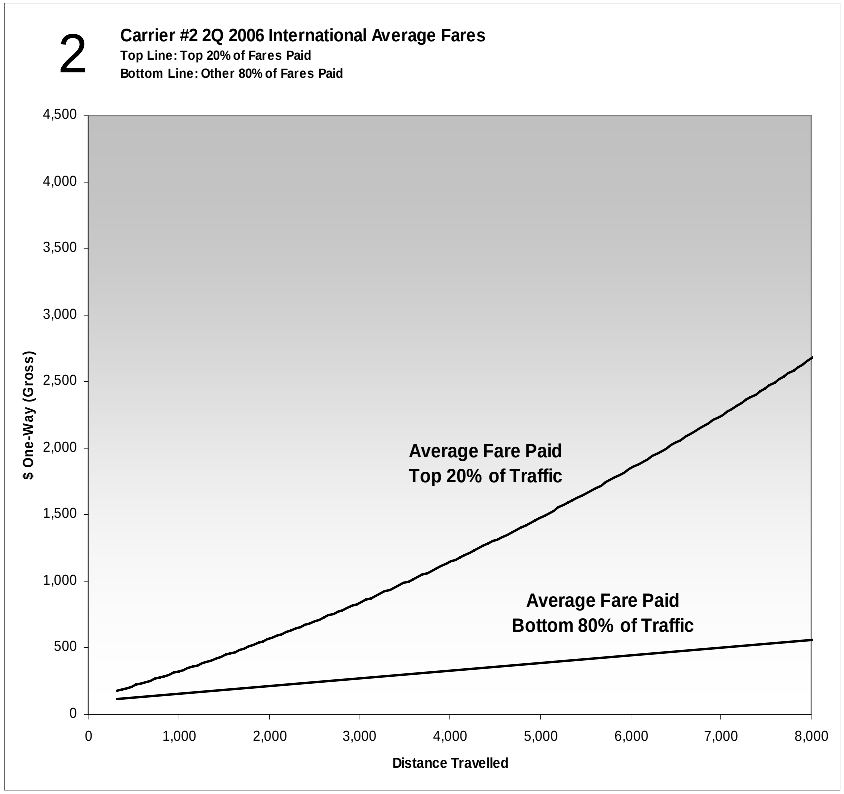
As distance increases, operating cost rises

- Fuel Burn
- Crew Cost
- Maintenance Cost
- Passenger Services
- Overflight

Incumbent carriers primarily make up this difference through substantially higher *premium* fares, not *economy* fares.

Sample Yield Curves by Distance





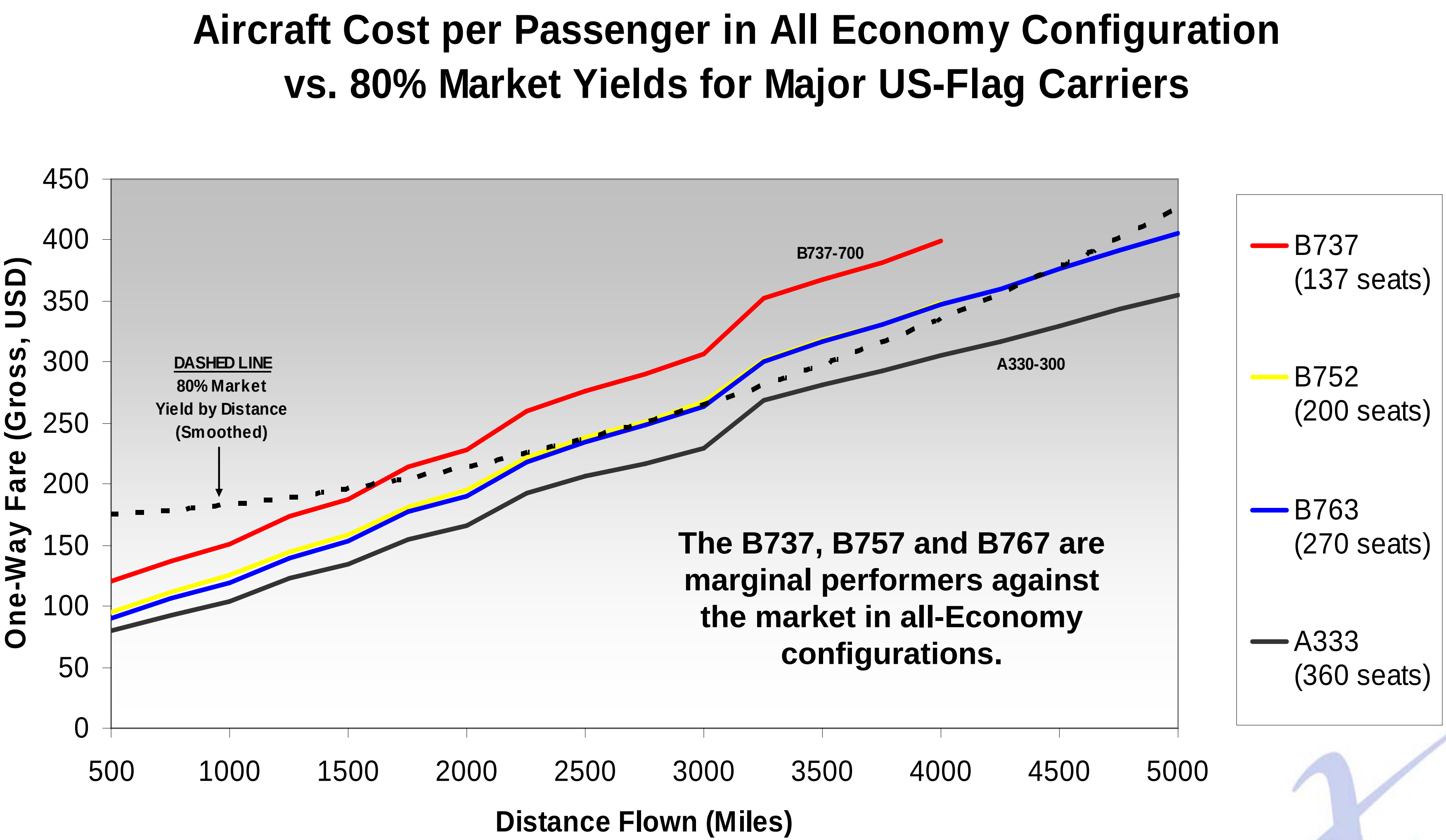
International yields for two US carriers have been divided into the top 20% and remaining 80% of fares paid and plotted against distance flown.

The increase in <u>Premium</u> fares is significantly higher than the increase in <u>Economy</u> fares.

The All-Economy Conundrum

Aircraft	Seats (32" Pitch)	Est. One-Way Cost for 3500 mi.	Req'd One-Way Fare at 80% LF
B737-700ER	137	$37,500	$340
B757-200	200	$50,000	$312
B767-300ER	270	$65,000	$300
A330-300	360	$75,000	$260

All-Economy Required Fares vs. Market Yields



What does this mean?

1

It's very difficult to achieve a fare advantage with all-Economy.

Economy fares increase slowly with distance

Narrowbody long-haul all-Economy has limited applications (shorter haul, low competition: YHZ-LON, BOS-SNN, DUB-BWI)

With a big plane, trade fare advantage for limited market applications

2

These dynamics have driven new models.

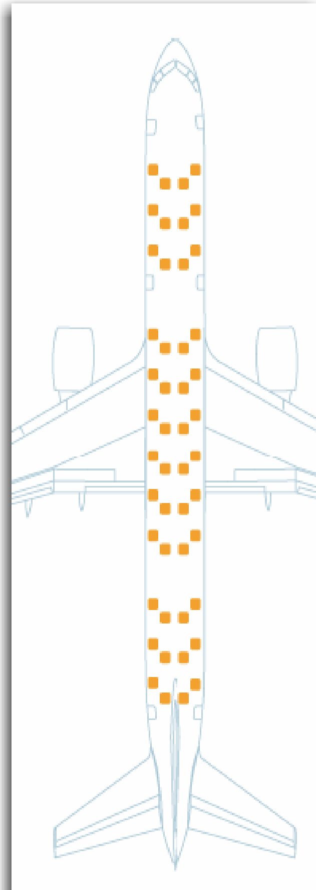
Product Specialists: premium aircraft attack higher-end pricing

Examples include MAXjet, Eos, Silverjet

Price Specialists: high-capacity aircraft stimulate lower-yield traffic

Examples include Oasis HK, JetStar, Zoom

Product Specialists



Eos Airlines

JFK - STN

48 seats per B757

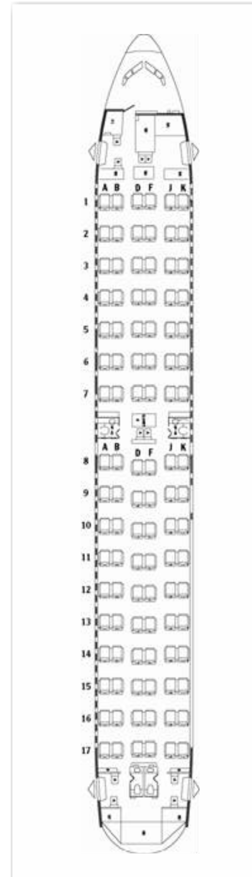
Focus:

High-Yield

Corporate VIPs

Key Differentiators:

Large horizontal bed with personal service



MAXjet Airways

JFK / IAD / LAS - STN

100 seats per B767

Focus:

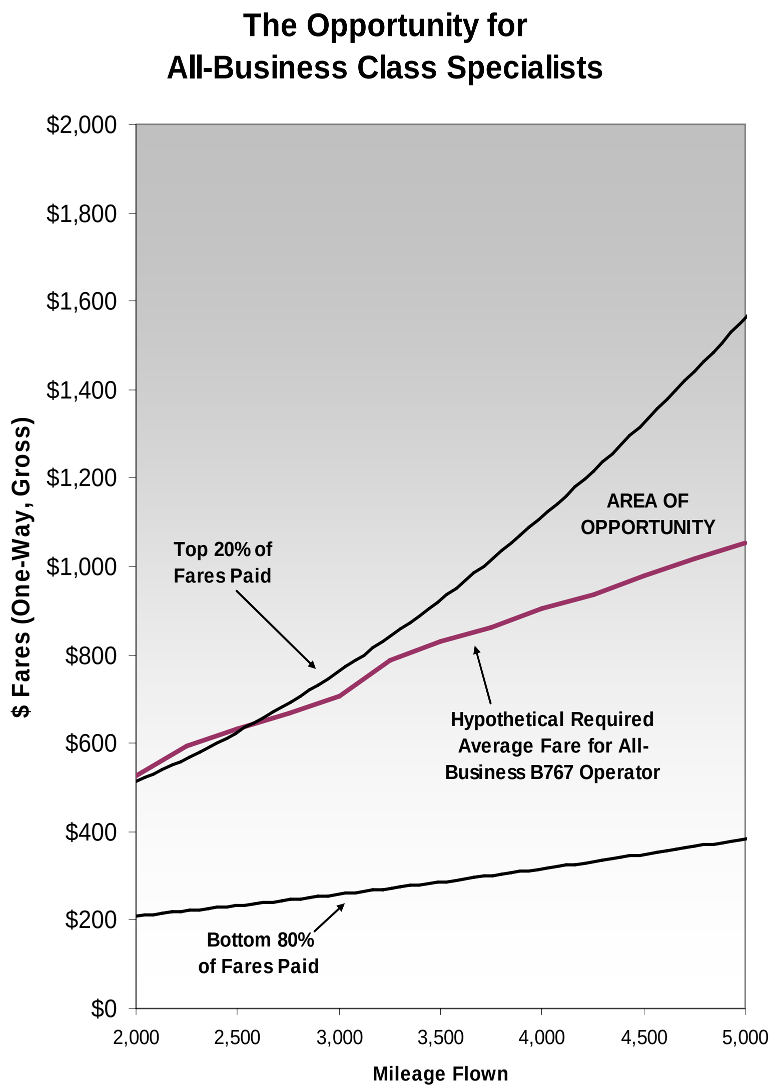
Large and small business

Affluent leisure

Key Differentiators:

Low, flexible fares for traditional Business Class

The Product Specialist Opportunity



Specialists capitalize on the relative strength of legacy yields in Premium cabins on longer-haul flights.

- The average of the top 20% of fares paid increases <u>faster</u> than the average of the bottom 80% of fares paid.
- This creates a pricing umbrella for value-driven Premium entrants.
- Requires a long-range aircraft
  - Gap increases with stage length
  - B767 offers a compelling combination of range vs. seating capacity

Trendlines are driven by Q2 2006 DOT data for US-flag carriers for international (Atlantic, Pacific, Latin) operations

Price Specialists

Oasis Hong Kong Airlines (Hong Kong)
Nonstop LGW-HKG with B747-400 aircraft.

81 Business Class seats and 278 Economy Class seats
A nominal low-fare carrier, but unclear cost advantage

Zoom Airlines (Canada)
Nonstop (only 1x or 2x weekly) in 15-20 long-haul markets.

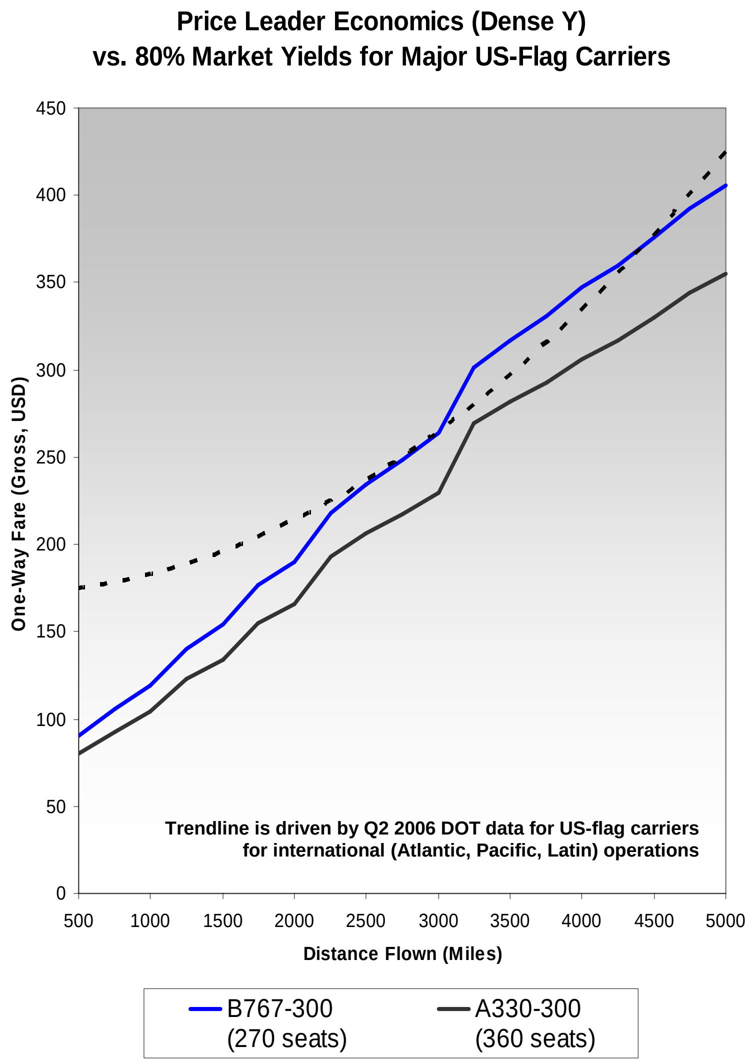
63 Premium Economy and 207 High-Density Economy seats
Aggregates price-sensitive traffic onto limited frequencies

Jetstar International (Australia)
Replacing Qantas mainline in lower-yield, long-haul markets

38 Premium Economy and 265 Standard Economy seats
Interesting combination of legacy network with high-density economics

Oasis photo by Xuan Hao, Zoom photo by Adrian Thompson, JetStar photograph by Brian Wilkes. All from airliners.net.

The Price Specialist Opportunity



These entrants use seating density to capture lower-yield traffic <u>profitably</u>.

- Works well in markets that cannot be served profitably by legacy airlines.
- Also works in markets where excess demand can be stimulated by low fares.
- Requires large aircraft with high-density seating configuration.
- Significant economic risk can be insulated through connectivity with other networks, participation in affinity program.

Conclusions

1 **We may see limited emergence of B737 long-haul all-Economy, but it's tough to differentiate on price.**

2 **Market dynamics create two opportunities for new entrants: Product Specialists and Price Specialists.**

3 **Looking forward, we should expect to see new variations on each of these models from both startups and legacy airlines.**

4 **These dynamics will likely change as new aircraft types reduce trip costs and cost per passenger (B787, A350).**